



# Basics of Private Equity

**Anita Stephens, General Partner**  
**Opportunity Capital Partners**

# What is Private Equity?

- Equity, and equity-related capital provided by institutional investors to entrepreneurs and their companies to finance the acquisition, expansion or start-up of a business
- Composed of two asset classes or types of investments:
  - venture capital and
  - buyout financing (sometimes itself called private equity)

# Venture Capital

- Typically, equity financing
- Provided to start-up's, or to young, existing businesses that have the potential to grow exponentially within a defined time period.
- Examples: Federal Express, ShopNow.com, Radio One
- Target risk-adjusted rate of return sought by a venture capital firm: 40%+

# Buyout Financing (Private Equity)

- Provided to entrepreneurs who wish to acquire an existing business, and/or to significantly increase the sales and cash flow of a business already owned.
- Financing typically provided in the form of senior equity or junior debt securities.
- Examples: TLC Beatrice, Simeus Foods International
- Target risk-adjusted rate of return sought by a private equity firm: 35%+

# Why should you seek private equity vs. other types of financing?

- Many young, growing companies can't handle paying monthly or quarterly bank debt service payments, particularly in their early years.
- Angels can be hard to find.
- In a large acquisition, you may need capital from a number of sources.
- Most private equity firms provide substantial value added services (relationships and contacts, experience, guidance, etc.)



# Basics of Private Equity

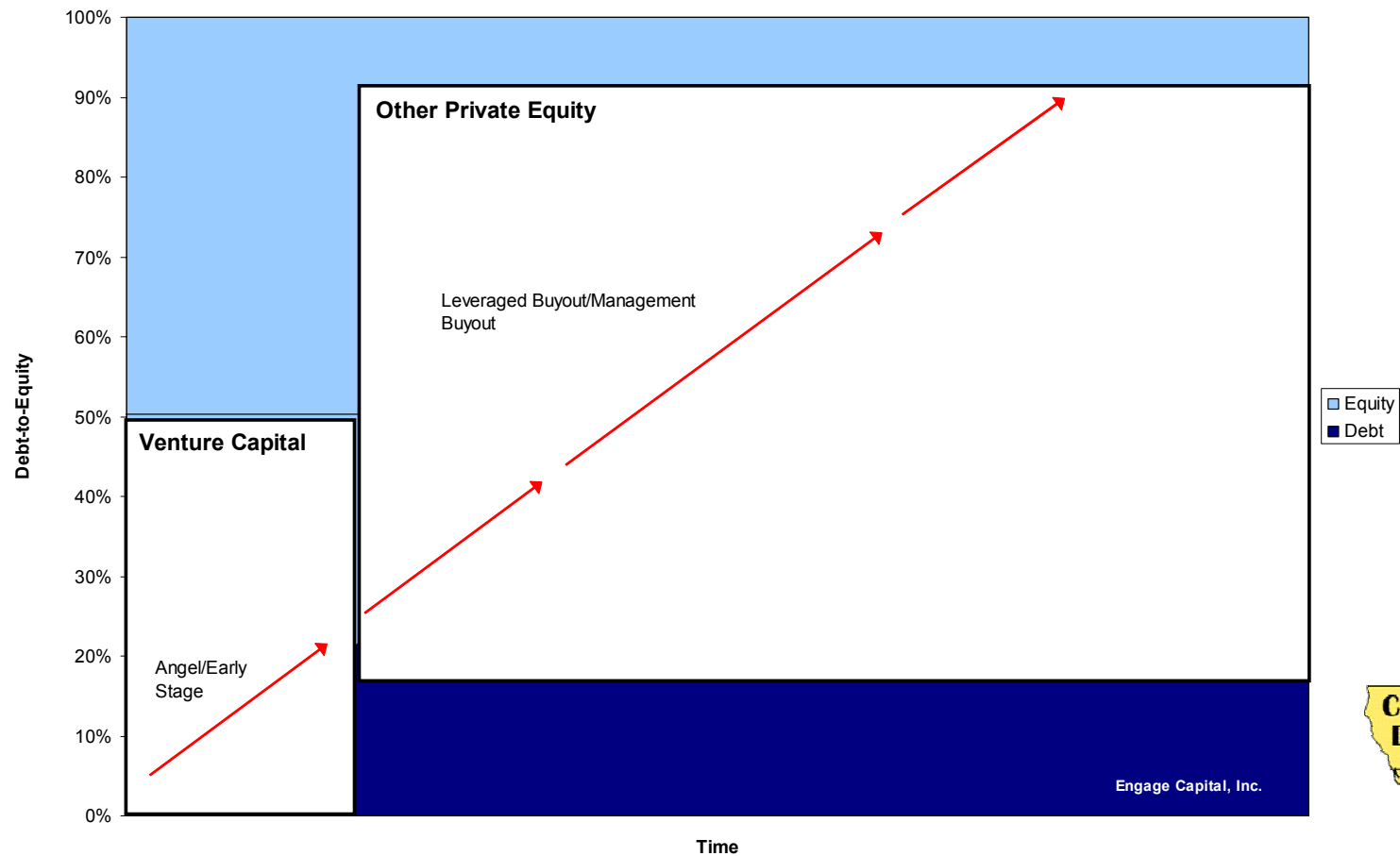
## Minority Business Focus

David Takata  
CEO, Engage Capital, Inc.





# Investment Continuum





# Typical Investors

- Strategic
  - Corporate funds
- Family/foundations/endowments
  - High net worth
- Institutional
  - Insurance company, merchant/investment bank, pension funds







# Goals of PE Investors

- Superior investment returns
  - Typically measured in IRR
  - Created with infusion of capital and/or talent
- Ownership prestige
  - Trophy property/asset
- Opportunity for exit
  - Seven-to-ten year fund life common





# What Excites Investors?

- Committed management and employees
- Differentiation
  - Knowing one's “unfair” advantage
- Growth potential
  - Industry expansion and/or market share
  - A solid plan to execute





# Challenges for All Firms

- Selling the story
  - Management, management, management
- Maintaining culture in many growth stages
- Improving the business
  - Is capital the only constraint?
- Defining the exit
  - Need to return capital to investors





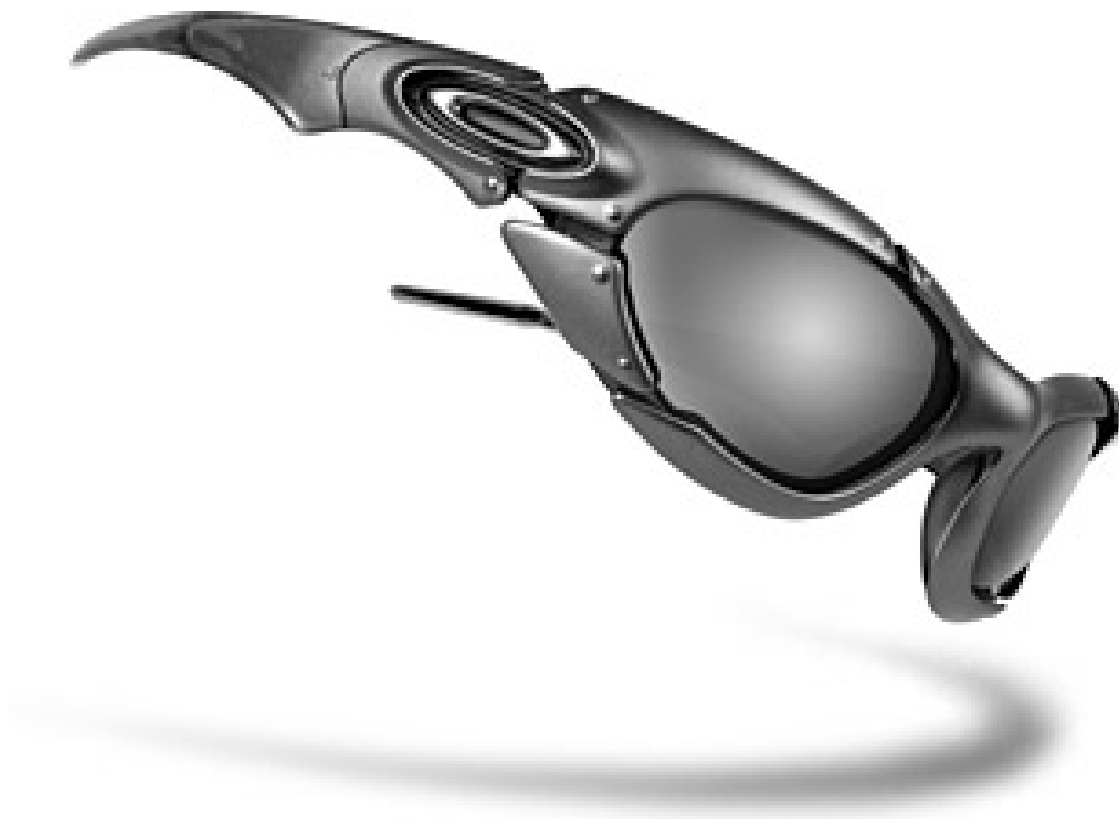
# Challenges for Minority Firms

- Loss of control by minority firm certifying agency
  - SBA Section 8(a)
  - National Minority Supplier Development Council
- Valuation of special contracts, tax credits, HR benefits, etc.





# Future Looks Bright





# Future Looks Bright

- Investor interest picking up
  - Census Bureau data
  - New funds filling gaps
- Corporate (strategic) mergers/partnerships in minority businesses picking up
  - Provides investors clear exit opportunity





# Fulcrum Capital Group

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Capital & Capability for Domestic Emerging Markets

*"Imperfect Markets Make Perfect Opportunities"*

Tools To Revitalize California Communities

October 17, 2003



# Private Equity Basics



# Accelerating Growth Wealth Creation and the Cost of Capital



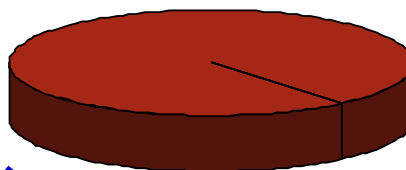
Founder Starts Business in 2001 with \$500,000  
The Business in 2003: \$4,000,000 Valuation

Assume value = 1 times revenue

## Founder's Option A:

Grow Business at \$1,000,000 yr  
No new money needed

Five Years  
Founder's Gain:  
\$5,000,000



Founders

## Founder's Option B:

Grow Business at \$3,200,000 yr  
Investors require 25% for  
\$1,000,000 stake

Five Years  
Founder's Gain:  
\$11,000,000 (2.2 x A)

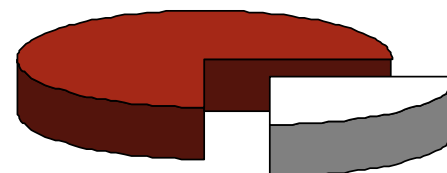
The Business in 2008: \$9,000,000 Exit Valuation



Founder:  
\$9,000,000  
(18% 5yr IRR)  
(51% 7yr IRR)

Founders

The Business in 2008: \$20,000,000 Exit Valuation



Founder:  
\$15,000,000  
(30% 5yr IRR)  
(63% 7yr IRR)

Investors:  
\$5,000,000  
(38% 5yr IRR)

Founders Investors



## The Fulcrum Mission

Fulcrum Capital Group manages three market-driven private equity funds delivering expansion and acquisition capital to light manufacturing, communications, and commercial/consumer services companies.



Focusing on rapidly growing companies owned or managed by minority entrepreneurs or located within Southern California's central urban communities, we have a strong, **double bottom-line objective** of attractive long-term rates of return to investors and targeted economic benefits to these communities



# The Fulcrum Approach



## **Focused Investment Experience**

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- **Over 25 years of institutional dedication to a “double bottom line”**
  - Existing team has over 60 years of combined private equity experience as principals
- **Fulcrum Venture Capital Corporation**
  - Organized in 1977 as a Federally licensed SBIC (“C” Corporation)
  - Financed over 40 minority-owned businesses in amounts from \$200,000 to \$1,500,000
- **Fulcrum Capital Management, LLC / Merrill Lynch EIP**
  - Organized in 1998 as a Limited Liability Company Investment Manager
  - RFP process allocation – Dollar matching in LA/Orange counties
  - Traditional private equity fund economics - Merrill Lynch holds assets directly

## **New Investment Partnership**

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- **Fulcrum Capital Partners, L.P.**
  - A limited partnership private equity fund primarily targeting Southern California based minority entrepreneurs and underserved urban communities.
  - Initial portfolio investment amounts of \$1,000,000 to \$5,000,000 with target company sales and valuations of \$5,000,000 to \$30,000,000
  - Targeted portfolio of investments in 12 to 15 companies over a 5-year investment period (with average initial investments of \$2,000,000 to \$3,000,000 per company)



## **Disciplined Investment Approach**

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- Expansion and acquisition capital to growing businesses
- Largely traditional, fragmented and consolidating sectors
- Strong cash flow with prudently leveraged capital structure
- Long-term equity and/or subordinate debt for sustainable growth
- Attractive growth prospects (internal & acquisition)
- Focus on management depth, breadth and ability to partner with Fulcrum
- All portfolio companies are minority owned, managed or provide employment to minority communities.



# **Fulcrum Capital Group**

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**Capital & Capability for Domestic Emerging Markets**

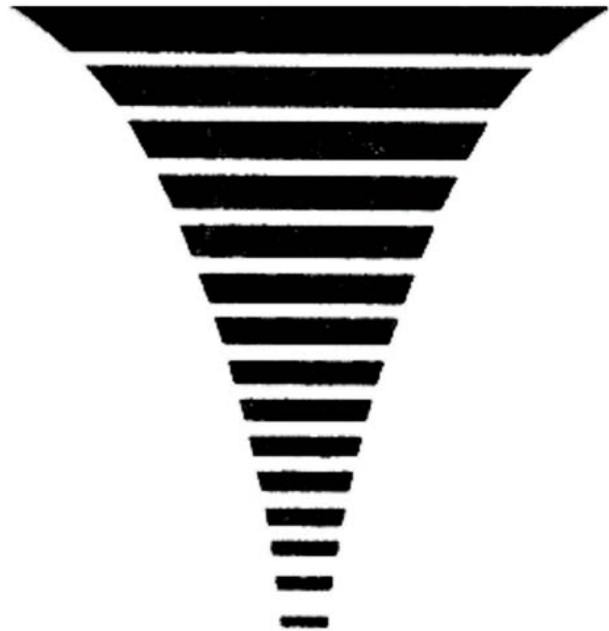


# Pacific Community Ventures

Established 1999

Pacific Community Ventures invests in and advises businesses located in and providing economic gains to low-income communities throughout California.

Capital:	\$20 million
Investment Size:	\$500 thousand - \$1 million
Investment Areas of Interest:	Expansion stage manufacturing, services, and spin-off businesses across industry segments.
Portfolio Company Characteristics:	<ul style="list-style-type: none"><li>• Sales from \$5 million to \$25 million.</li><li>• Management must have a material equity interest that is economically and philosophically aligned with PCV's double bottom line mission.</li><li>• Company must have the ability to employ at least 25 low-income individuals in a manner congruent with the Company's projected growth.</li></ul>



**ON TOP COMMUNICATIONS**

# **Basics of Private Equity Investing**

**September 2003**



## *Keys to raising capital in the private equity market*

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- **Identify your company needs**
- **Assemble your team**
- **Craft your story**
- **Target the right investors**
- **Structure the right deal for you**



Company Needs

Management Team

PPM

Target Investors

Deal Terms

## *Identify your company needs*

### *The On Top Story*

- **What do you need the money for?**
  - Seed capital to start your business
  - Expansion capital to enter a new market
  - Expansion capital to acquire a business
  - Capital for new product Development
  - Capital for operational needs
- **How much money?**
- **What type of money? Debt of Equity?**

- On Top Communications, LLC acquires, owns and operates FM radio stations located in the Southeastern United States.
- The company started in 1998. In 2001 it began raising private equity capital to repay debt, grow through acquisitions and to provide working capital
- On Top raised \$20 million over eighteen months from 10 private equity investors. More than 40 investors were approached during the fund raising process
- With this capital, On Top has now grown to 5 stations in 4 markets



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Deal Terms

## *Assemble your team*

- **Does your management team have the right skills and experience?**

- Industry expertise
- Operations experience
- Financial expertise
- Leadership skills

### *The On Top Story*

**Founder/CEO: Steve Hegwood**

- Negotiated On Top Communications acquisitions
- 7 years as VP of Programming at Radio One overseeing 40 radio stations
- Increased ratings of radio stations an average of 140% during his career
- Consistent member of Radio Ink's Most Influential African Americans in Radio
- Billboard Magazines' Programming Director of the year for Urban Radio

**Chief Financial Officer: Leonard Rayford, Jr.**

- Raised, negotiated and structured \$20 Million in venture capital financing for OTC
- Served as a financial consultant for early stage companies raising \$8 Million in financing
- Worked in all aspects of principal investing at TD Capital
- B.A. in Economics from UNC-Chapel Hill and M.B.A. from Columbia University



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## ***Craft your story***

### **Does your business plan contain all the essential elements?**

- Company description
- Company strategy
- Founder/Management Team
- Market/Industry Overview
- Competition
- Risk
- Historical Financials and Projected Financials
- Capitalization
- Use of Proceeds

A Private Placement Memorandum (PPM) is a business plan that describes both your business and the specific opportunity for which investment is being sought



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## ***Target the right investors***

### **Have you identified the right investors?**

#### *Things to consider:*

- Industry that investor invests in
- Typical structure that investor uses
- Investors' time frame for repayment
- Typical investment size
- Passive or active investor

### ***The On Top Story***

- On Top focused its fund raising efforts on companies with a track record of investing in minority and/or entertainment and media ventures
- We focused on investors that could provide capital as well as industry contacts and expertise, whose ongoing involvement would be beneficial to the company
- Our investors all require payment within 4 - 6 years; the longer time frame which will allow the business time to grow and develop positive cash flow



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PPM

Target Investors

**Deal Terms**

## ***Structure the right deal***

### **Are you securing the right financing for your company's needs?**

#### *Things to consider:*

- Debt  
Appropriate for companies with cashflow to support the interest payments
- Equity  
Appropriate for companies that can not afford interest payments
- Mezzanine  
Combination of debt and equity

### **Closing the deal**

- Agree on terms including interest rate and ownership that the investor will receive
- Complete Due Diligence period
- Document the deal
- Wire funds!!!